No. 137 16

OCTOBER TERM, 1937.

IN THE

Supreme Court of the United States

EPHRAIM LEDERER, Collector of Internal Revenue for the First District of Pennsylvania, Petitioner,

vs.

ALEXANDER D. STOCKTON, Sole Surviving Trustee under the Will of Alexander J. Derbyshire, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

MAURICE BOWER SAUL,
Attorney for Respondent.

JOSEPH A. LAMORELLE,
SAUL, EWING, REMICK & SAUL,
Of Counsel.

INDEX.

AUTHORITIES CITED.

In the Supreme Court of the United States.

OCTOBER TERM, 1921. NO. 137.

Ephraim Lederer, Collector of Internal Revenue for the First District of Pennsylvania, Petitioner,

vs.

Alexander D. Stockton, Sole Surviving Trustee under the Will of Alexander J. Derbyshire, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

COUNTER STATEMENT OF QUESTION INVOLVED.

Whether or not income of a charitable organization, no part of the net income of which enures to the benefit of any private individual, is subject to income tax under either the Revenue Act of 1916 or the War Revenue Act of 1917.

ARGUMENT.

THE INCOME OF A CHARITABLE ORGANIZATION NO PART OF THE NET INCOME OF WHICH ENURES TO THE BENEFIT OF ANY PRIVATE INDIVIDUAL, IS NOT SUBJECT TO INCOME TAX UNDER EITHER THE REVENUE ACT OF 1916 OR THE WAR REVENUE ACT OF 1917.

The only question for the determination of this Court is whether or not the Trustee of the Estate of Alexander J. Derbyshire, deceased, is obliged to pay an income tax under the Revenue Act of 1916 or the War Revenue Act of 1917, on the accumulations of income which pass to the "Contributors to the Pennsylvania Hospital", a purely public charity.

In the District Court and the Circuit Court of Appeals, the question was also presented as to whether or not there was any obligation on the Trustee to pay income tax on the said accumulations of income under the Revenue Act of 1913. Since arguing this case, in the Lower Courts, this Court has in Smietanka *vs.* First Trust and Savings Bank, Trustee, U. S. Adv. Ops. 1921-22 page 647, (decided February 27, 1922), decided the question raised in this case under the 1913 Act favorably to the respondent. That the decision in Smietanka *vs.* First Trust and Savings Bank Trustee, is controlling in this case insofar as the 1913 Act is concerned is conceded by the petitioner (page 4 of its brief) and therefore, in any event the respondent is entitled to judgment in the amount of $2555.23, with interest thereon from July 3, 1917, which amount represents taxes illegally collected for the years 1913, 1914 and 1915.

As set forth above, the question here involved is whether or not the said Trustee was obliged to pay an income tax on the said accumulations of income under the Revenue Acts of 1916 and 1917.

These Acts may be considered together, since the latter Act did not change the parties upon whom taxation was imposed, but changed only the rate of taxation.

Section 2, (*b*) of the Revenue Act of 1916, (39 Stat. 757) provides:

"Income received by estates of deceased persons dur-
"ing the period of administration or settlement of the
"estate, shall be subject to the normal and additional
"tax and taxed to their estates, and also such income
"of estates or any kind of property held in trust, in-
"cluding such income accumulated in trust for the bene-
"fit of unborn or unascertained persons, or persons with
"contingent interests, and income held for future dis-
"tribution under the terms of the will or trust shall be
"likewise taxed, the tax in each instance, except when
"the income is returned for the purpose of the tax by
"the beneficiary to be assessed to the executor, admin-
"istrator or trustee, as the case may be: *Provided*,
"That where the income is to be distributed annually
"or regularly between existing heirs or legatees, or
"beneficiaries the rate of tax and method of comput-
"ing the same shall be based in each case upon the
"amount of the individual share to be distributed."

It cannot be denied that the "Contributors to the Pennsyl-
"vania Hospital" has a vested interest (Biddle's Appeal 99 Pa. 525 and Derbyshire's Est. 239 Pa. 389), and since it is an ascertained corporation, income accumulated for its benefit does not come strictly within the wording of the clause of the Act above set forth. It is true, that the will directs that the income be held for future distribution, and while it might possibly be considered subject to tax under the clause above set forth standing alone, it cannot be considered a proper subject of taxation in view of the provisions of Section 11, (*a*) of the same Act, (39 Stat. 766), which provides:

"That there shall not be taxed under this title any
"income received by any—

"Sixth-Corporation or association organized and
"operated exclusively for religious, charitable scientific
"or educational purposes, no part of the net income of
"which enures to the benefit of any private stockholder
"or individual."

It is submitted that the exemption accorded to charitable organizations under the provision above set forth, is broad enough to relieve from taxation the income which is accumulated under the provisions of the Will for "The Con- "tributors to the Pennsylvania Hospital."

All of the income accumulating on the said trust fund is distributable to two beneficiaries, namely, Mrs. Caroline Derbyshire Schelling, who receives $800, per annum, and the "Contributors to the Pennsylvania Hospital," which receives the balance of the income.

The petitioner has admitted in paragraph 6, of its affidavit of defense, that the "Contributors to the Pennsylvania "Hospital" is a purely public charity, that the accumulations of income received by it are used exclusively for charitable purposes, and that no part of the net income of the said "Contributors to the Pennsylvania Hospital," is for the benefit of any private stockholder or individual. (Transcript of Record, pages 5-11-12-13.)

It must necessarily follow therefore, that since the "Con- "tributors to the Pennsylvania Hospital" is a charitable organization, and not subject to tax under the said Revenue Acts of 1916 and 1917, that the fiduciary in this case, namely, the Trustee under the Will of Alexander J. Derbyshire, is not required to pay any tax, since the beneficiaries under the trust are not persons subject to tax under the provisions of the said Act.

It cannot be denied that if the Trustee in this matter, is compelled to pay a tax on these accumulations, the burden of paying same must necessarily fall on the "Contributors "to the Pennsylvania Hospital," and, as a result, the income to the said Contributors, is being made subject to an income tax, in spite of the fact that Congress has expressly stated that charitable organizations are not liable for same.

The clear purpose of this Act was to exempt from taxation charitable bequests, and to hold corporations organized for charitable purposes, no part of the net income of which enures to the benefit of any private stockholder or individual, free from the burden of taxation.

The petitioner contends that the clear intent of Section 2, (*b*), of the said Act, is to tax accumulations of income in the hands of Trustees during the period of the trust, and, were this paragraph the only one in the Act bearing on this question, it is possible that the accumulations might be taxable in the hands of the fiduciary. However, it is submitted that in ascertaining the intention of the framers of the said Act, all of its provisions bearing on the question here involved, must be read together.

Section 11, (*a*), of the Act, clearly and plainly exempts charitable organizations such as the one here involved, from the burden of taxation, and it is submitted that the provisions of that section must be read in conjunction with the provisions of Section 2, (*b*), and the limitations of Section 11, (*a*), read into Section 2, (*b*), as an exception to the general principle therein laid down.

Even should there be any doubt as to whether or not the fiduciary in this case is taxable under the provisions of these two sections, the doubt should be determined in favor of the taxpayer.

In the case of Gould *vs.* Gould, 245 U. S. 151, the Supreme Court of the United States said:—

> "In the interpretation of statutes levying taxes it is "the established rule not to extend their provisions "by implication beyond the clear import of the language "used or to enlarge their operations so as to embrace "matters not specifically pointed out. In case of doubt "they are construed most strongly against the Govern- "ment and in favor of the citizen."

It is submitted that petitioner's contention, if upheld, in construing Section 2, (*b*), as rendering the fiduciary liable to taxation on the accumulations of income in the case at bar, defeats the clear intent of Congress as expressed in Section 11, (*a*).

It is clear that the fiduciary is not liable for tax on the annuity of $800, payable to Mrs. Schelling, since it is less than the specific exemption allowed individuals under every

one of the taxing acts, and because the tax, if any there be, is payable by the beneficiary and not by the fiduciary, since the annuity is distributed to her annually.

So much therefore, of the income as is payable to her is clearly exempt from taxation, in the hands of the Trustee. All of the income not so payable, is, under the terms of the will, payable to a charitable corporation, no part of the net income of which enures to the benefit of any private stockholder or individual, and this corporation because of its purposes, is exempt from taxation on income under the expressed provisions of the said Act.

It is contended by the petitioner that the accumulations of income to this trust, which pass to the "Contributors to "the Pennsylvania Hospital," is not exempt from taxation in the hands of the fiduciary, since it has not been received by the charitable organization, and, that under the provisions of Section 11, (*a*), of the said Act, only income which is *received* is exempt.

It must be borne in mind that an attempt was made to turn over this trust fund with accumulations to the charitable organization some years ago, withholding a sufficient amount to pay the annuitants.

The Supreme Court of Pennsylvania however, in Biddle's Appeal, 99 Pa. 525, wherein the title to the residue was adjudged *vested* in the hospital, held that the said fund should not be paid to the hospital until after the death of all the annuitants, since this was the clear intent of the testator as expressed in his will, and that even if no one were harmed by the turning over of the said fund to the hospital, none-the-less, the testator was entitled to have the provisions of his will carried out, regardless of his reasons for same.

Subsequently, the trustee resorted to the practical expedient of investing the income of the estate in the form of a loan to the charitable institution, upon which loan the charitable institution paid interest to the trustee sufficient to take care of the administrative charges, and the payment of the annuities. While, therefore, the income remains theoretically and for purposes of accounting in the

hands of the trustee, nevertheless, it is in fact in the possession of the hospital in the shape of money loaned on mortgage, upon which loan, the hospital is paying to the trustee, interest which in turn is loaned to the hospital under the blanket mortgage. As a matter of fact, therefore, the hospital is and has been *receiving* the income from this fund, and on this income, the petitioner has collected a tax, in spite of the express wording of the Act exempting such income.

The trustee of course, has no financial interest in the residuary payment, and while the tax is in theory assessed on income received by the trustee for the testator's estate, the whole amount is paid at the expense and from the income of the hospital, which clearly burdens the hospital, a charitable organization, with tax, on its income received from this fund.

It is clear therefore, that the accumulations of income, have in fact already been received by the hospital, and the hospital itself is paying the tax which the petitioner assessed and collected. We therefore, have the anomalous situation of the hospital, a charitable organization, paying a tax on income actually received by it. Assuming however, that the hospital did not actually receive the income on this trust fund, this fact would not change the situation. With the exception of $800, there is no one interested in the income, except the hospital, which has a vested interest in the entire fund, and must ultimately receive, the said income. The trustee therefore, would become the agent of the hospital, and receipt by an agent is receipt by his principal.

Judge Buffington in his opinion in the Circuit Court of Appeals, in commenting on this phase of the case states (266 Fed. 678):—

> "As justification for assessing this tax, it contended, "however, that as the Act of 1916 forbids taxation of "'any income *received* by any * * * corporation "'* * * for * * * charitable * * * purposes,' "that the income of this residuary estate was not ex-

"empt because it has not been 'received', but remains "in the hands of the trustee. But, apart from the fact "that the corpus of the residuary estate has in fact "already been 'received' by the hospital in the shape "of a mortgage, and the hospital itself is pro forma "paying to its own trustee the money which pro forma, "constitutes the income here taxed, the construction "thus urged and the effect given to the word 'received' "does not commend itself to our judgment. The sec- "tions in question in the acts of 1913 and 1916 are "to be considered and construed jointly. They con- "cern the same subject-matter, and that of 1916 was "evidently meant to continue the broad and absolute "purpose and provisions of the Act of 1913 'that noth- "'ing in this section shall apply * * * to any "'corporation * * * operated exclusively for "'* * * charitable * * * purposes.' Such "being the case, the residuary estate which produced "this income being the property solely of the hospital, "no one but the hospital owning the income thereof, "and the temporary holding of the income being by a "trustee, who was the agent and representative solely "of the hospital, it is clear that when substance and "spirit, and not mere form and words, are the inter- "preters of the statute, the receipt of this income by "the hospital's agent and representative was in truth "and reality a receiving by the hospital, for he who "acts by the hand of another himself acts. If this "income was received from a third person by the trus- "tee and afterwards lost, surely the hospital could "never have collected it again from such third person "on the theory the hospital had never received it. "Moreover, it will also appear that, if the trustee had, "without protest, used the money of the hospital to "pay this income tax, such trustee could not, on settle- "ment of his trusteeship, have justified such payment "under Section 2 of the Act of 1913, for that section "only warrants such deduction and withholding where "the income is the 'income of another person subject

"'to tax' and elsewhere, as we have seen, the same "section provided, 'that nothing in this section shall "'apply * * * to any corporation * * * "'operated exclusively for * * * charitable "'* * * purposes.'"

Counsel for Petitioner argues that since the clause exempting charitable organizations from tax is contained in Section 11, (*a*), it has no application here, and applies only to taxes levied under Section 10 of the Act. Counsel for Petitioner however, in his argument has ignored the very wording of the Act. Nowhere in Section 11, (*a*) is there any expression to the effect that it applies only to taxes levied under Section 10 of the Act. It contains no limitation. On the contrary it provides, "that there shall not be taxed under *this title* any income" etc. The title therein referred is title 1 of the Act, which is as follows:—"Title 1—Income tax," and includes Section 2 (*b*), the Section under which this tax has been assessed and collected. The exemption therefore granted to charitable organizations under Section 11, (*a*) of the Act, renders all such organizations free from the burden of paying income tax. Section 11, (*a*) therefore, in clear unmistakable terms exempts from income taxes, the income of all charitable organizations, such as the one here involved.

Congress in framing the Revenue Acts of 1916 and 1917, has clearly indicated its intention to exempt charitable organizations from income tax, and properly so—for it would be highly improper for Congress to attempt to collect income tax from organizations which are dependent for their support on charitable contributions. This is no doubt the motive which prompted the framers of these acts, to exempt such corporations from the burden of paying income tax, and it would be inconsistent for Congress, as now contended by the Petitioner to exempt charitable corporations from income tax under one part of the Act, and impose taxes under another part of the same Act.

Counsel for the Petitioner argues that this tax should be collected because the charitable organization has not re-

ceived the income. As stated above, and of this fact there can be no denial, the "Contributors to the Pennsylvania "Hospital" is receiving the income from this trust fund every year. It is a fact therefore, that the income is received by the corporation, and section 11, (*a*) of the Act expressly exempts income received by such a corporation. It is not therefore, a case of income received by a third person as to which there is a possibility, probability, or even certainty that it will be paid to a charitable corporation at some future time, as stated by Counsel for Petitioner in his brief, but is a case of the income actually being received and used by the corporation year after year.

Counsel for Petitioner refers to the taxing statutes of Massachusetts and New Jersey, and cites cases for the proposition that while these statutes exempt property in the service of a charity, they do not extend the exemption to property owned but not occupied by a charity, which property the charity intends to use at some future time for the purpose of its charitable work. These cases refer to tax on real property and have no application to the present case.

In Boston Society etc. *vs.* the City of Boston, 129 Mass. 178, cited by Counsel for the Petitioner, the City of Boston assessed a tax on a piece of land owned by a charitable organization. The land in question was not at that time used for any purpose, but the said organization intended at some future time to erect a wooden school building on the land. The taxing statute provided that land and buildings used for purposes of worship, should be exempt from taxation, and the Court very properly held that since the land in question was not being used for worship, it was not exempt from tax. The Court also stated that under the facts in that case, there was nothing to prevent the corporation from alienating the property at some future time, and there was no obligation on them to use it for purposes of worship at any future time.

In Presbyterian Board *vs.* Fisher, 68 N. J. L. 143, cited by Counsel for the Petitioners, the same question was involved. There the law provided that

"all buildings used exclusively for charitable purposes
"with the land whereon the same are erected, and the
"furniture and personal property used therein"

shall be exempt from taxation. There a mansion house was devised to be used as a home for disabled ministers and widows of ministers. It appeared that during the year in which the tax was assessed, there were no inmates of the home, and that no one was in possession, except a caretaker. There again the Court said that since the property was not used for the purpose for which it was given it was not exempt. In the present case, however, the income which the Petitioner has taxed, is actualy being received and used at the present time by the "Contributors to the "Pennsylvania Hospital," and of this there can be no denial.

The above cases cited by appellant have no bearing on the question in the present case, as the question involved in those cases was whether or not the property sought to be taxed was *used* by the corporation for a charitable purpose.

Those cases involved the question of actual user for a charitable purpose, while in the present case we have a different question to determine—Is the income sought to be taxed the income of a charity? If so, it was not the intention of Congress to tax it.

Counsel for Petitioner cites Smietanka *vs.* First Trust and Savings Bank, *supra*, for the proposition, that even though Congress may have intended to exempt all income which might ultimately go to a charity, the Court cannot give effect to this intention if there are no words in the statute which can be construed as granting an exemption in a case which falls expressly within the taxing provisions of the statute.

It is submitted that Congress by Section 11 (*a*), clearly expresses its intention of exempting from tax the income received by charitable organizations, and that the case at bar falls squarely within the provisions of this exempting clause.

Cornell *vs.* Coyne, 192 U. S. 418, and Swan & Finch Co., *vs.* United States, 190 U. S. 143, 146, cited by counsel for

petitioner, have no application here. The principle laid down in those cases is well established, but does not apply here, since this is not a case of resolving a doubt, where an exemption is claimed against the one claiming same, but on the contrary, is a case of granting an exemption to one entitled to same under the expressed provisions of the Act.

Counsel for Petitioner argues that Section 219 (*b*) of the Revenue Act of 1918, which authorized trustees to deduct income permanently set aside for a charity in computing the income of the trust estate, raises no inference that Congress intended to permit a like deduction to be made in computing the income of trust estates under the Act of 1916. On the contrary, it is submitted that this provision, together with the provisions contained in the subsequent act, raises a very strong inference that Congress has always intended that such deduction should be permitted in computing the income of trust estates, subject to tax. The intention of Congress in this respect can be clearly seen in all the taxing acts.

It is clear from all the Revenue Acts from that of 1913 down to and including the Act passed on November 23, 1921, that Congress intended charitable organizations to be entirely exempt from the burden of income tax. Section G (*a*) of the Act of 1913 clearly provided that charitable organizations should not be subject to income tax. Section 11 (*a*) of the 1916 Act exempts charitable organizations from any tax under that title—the entire title referring solely to income tax. Sections 219 and 231 of the Act of 1918 provided that charitable organizations shall be exempt from tax. The former section applied to income in the hands of a trustee, either paid to or set aside for charitable organizations, while the latter section applied to income actually paid to such organizations. Provisions similar to those contained in the 1918 Act are embodied in the Act of 1921, and while it is true that the framers of the 1916 Act may not have expressed themselves as clearly as did the framers of the 1918 and 1921 Acts, nevertheless

the intention is clear in all the Acts, that charitable organizations shall be exempt from the burden of income tax. In determining whether or not a given case is within an exemption contained in a taxing statute, it is proper as an aid towards such determination, to give weight to the general policy of the Legislature in adopting the exemption. Peoples *ex rel* Standard Oil Company *vs.* Saxe *et al,* 166 N. Y. S. 887.

To sum up, the "Contributors to the Pennsylvania Hos- "pital" is a purely public charity, no part of the income of which enures to the benefit of any individual or private stockholder.

The said corporation during the years 1916 and 1917 received income from this trust fund. The petitioner herein assessed and collected an income tax from the trustee for those years, which income tax must be paid from the income received by the hospital. It is a fact, therefore, that the burden of paying income taxes in this particular matter has fallen directly on the hospital, which clearly defeats the intention of Congress as expressed in Section 11 (*a*), of the Revenue Act of 1916.

It is submitted therefore, that no part of the income to this estate is subject to taxation under any of the Revenue Acts above referred to; that the tax has been illegally and erroneously assessed, and collected, and that the judgment entered in the District Court and affirmed in the Circuit Court of Appeals should be affirmed by this Court.

Respectfully Submitted,

MAURICE BOWER SAUL,
Attorney for Respondent.

JOSEPH A. LAMORELLE,
SAUL, EWING, REMICK & SAUL,
Of Counsel.